Supreme Court, U.S.
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No. _____

IN THE
Supreme Court of the United States

COUNTY BANK OF REHOBOTH BEACH, DELAWARE AND MAIN STREET SERVICE CORPORATION,

Petitioners,

v.

JALIYAH MUHAMMAD,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Jersey

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This case, in which the New Jersey Supreme Court determined that the class arbitration waiver contained in the parties' arbitration agreement was unconscionable and unenforceable because the Respondent's claim was a "low value" consumer claim, presents the following three questions:

- Whether the New Jersey Supreme Court erroneously ruled – in conflict with the Federal Arbitration Act, this Court's precedents and multiple state courts and federal courts of appeal – that a class arbitration waiver in an otherwise enforceable arbitration agreement is unenforceable and must be stricken;

- Whether the New Jersey Supreme Court's ruling violates Petitioners' right to due process because it applies a new interpretation of New Jersey law retroactively to the parties; and,

- Whether the New Jersey Supreme Court's ruling unduly burdens interstate commerce by seeking to impose special requirements on arbitration agreements that are contrary to the Federal Arbitration Act.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioners County Bank of Rehoboth Beach, Delaware and Main Street Service Corporation were defendants, appellees and respondents below. Easy Cash and Telecash, named as defendants, appellees and respondents below, are trade names of County Bank and not listed here.

Respondent Jaliyah Muhammad was plaintiff, appellant and petitioner below.

Pursuant to S. Ct. Rule 29.6, Petitioners state that there is no parent or publicly held company that owns 10% or more of the stock of County Bank of Rehoboth Beach, Delaware or Main Street Service Corporation.

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County Bank of Rehoboth Beach, Delaware ("County Bank") and Main Street Service Corporation ("Main Street") respectfully petition for a writ of certiorari to review the judgment of the New Jersey Supreme Court in this case.

OPINIONS BELOW

The opinion of the New Jersey Supreme Court entitled *Muhammad v. County Bank et al.*, is not yet reported (although it is available at 2006 WL 2273448) and reprinted in the attached Appendix A ("App."). The order of the New Jersey Supreme Court denying reconsideration of its decision is unreported and reprinted at App. E. The opinion of the New Jersey Superior Court, Appellate Division is reported at 379 N.J. Super. 222 (2005) and reprinted at App. B. The New Jersey Superior Court Trial Division's order granting the Petitioners' Motion to Stay Action Pending Arbitration and Compel Arbitration is unreported and reprinted at App. C.

JURISDICTION

The New Jersey Supreme Court issued its decision on August 9, 2006. App. A. The court denied rehearing on October 5, 2006. App. E. Petitioners invoke this Court's jurisdiction pursuant to 28 U.S.C. § 1257.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the United States Constitution, U.S. Const., art. VI, cl. 2:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; * * * shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the

Constitution or Laws of any state to the Contrary notwithstanding.

The Fourteenth Amendment to the United States Constitution, U.S. Const. amend. XIV, § 1:

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

The Commerce Clause of the United States Constitution, U.S. Const. art I, sec. 8, cl. 3:

> The Congress shall have power * * * To regulate Commerce with foreign Nations, and among the several States * * *

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 ("FAA"):

> A written provision in any * * * contract evidencing a transaction involving interstate commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction * * * shall be valid, irrevocable, and enforceable, save upon such grounds as exist in law or equity for the revocation of any contract.

INTRODUCTION

Muhammad presents three constitutional issues, one of which has sharply split multiple state and federal courts, while the other two are challenges to long established commerce clause and due process principles.

First, if the terms of the agreement to arbitrate expressly preclude class procedure, can a state court alter that agreement in any way? Is such a ruling preempted by the FAA? This Court posed these questions without answering them in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and the time is now right for an answer.

Second, this Court disfavors retroactivity in the law. Ignoring this Court's precedent, the New Jersey Supreme Court applied a new interpretation of its law retroactively, imposing its new interpretation on parties previously in compliance with both New Jersey law as it existed at the time of their contracts and Delaware state law, which the parties chose as governing law in their agreement. The unconstitutionality of New Jersey's retroactive application of the law requires this Court's review.

Third, the Constitution vests power to regulate interstate commerce in Congress. State regulation of interstate commerce must yield to Congress' expressed intent, yet New Jersey will not. *Muhammad's* holding imposes far-reaching burdens on interstate commerce where Congress has clearly expressed its intent that arbitration clauses in contracts affecting interstate commerce be favored, rather than burdened.

These issues need certiorari review now.

- **The Circuits and the States are split. S. Ct. Rule 10(b).**

The New Jersey Supreme Court joins California and the U.S. Courts of Appeal for the First and Ninth Circuits as jurisdictions choosing to treat arbitration agreements in "low value" cases differently than other contracts. As discussed below at pp. 15-17, these jurisdictions have held that the class action waivers included in arbitration agreements are

unenforceable in low value consumer cases. In contrast, many state and federal circuits hold either that courts may not order class wide arbitration unless the parties have so agreed, or that, if the parties have agreed not to arbitrate as a class, the contract between the parties is not unconscionable.

The Seventh Circuit, for example, has held that courts are without authority to order class-wide arbitration unless the parties have expressly agreed to that procedure. *Champ v. Siegel Trading Co.*, 55 F.3d 269, 276-277 (7th Cir. 1995). The Third, Fourth, Eighth, and Eleventh Circuits—unlike the New Jersey Supreme Court—have enforced arbitration agreements despite the unavailability of class action procedures under those agreements.[1] The decision below likewise conflicts with the decisions of the Second, Fifth, Sixth, Eighth, and Eleventh Circuits, all of which have reached the related conclusion that the FAA precludes courts from requiring consolidation of arbitration proceedings unless the parties expressly agreed to do so in their arbitration agreements.[2]

- **The New Jersey ruling directly conflicts with the decisions of this Court. S. Ct. Rule 10(c).**

This Court often has admonished that arbitration agreements must be enforced according to their terms—even in more drastic cases, such as when enforcement of the agreement results in piecemeal litigation of the contracting parties' claims or an order to compel arbitration of a contract

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[1] *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 638-639 (4th Cir. 2002), *Dominium Austin Partners, L.L.C. v. Emerson*, 248 F.3d 720 (8th Cir. 2001); *Randolph v. Green Tree Fin. Corp.*, 244 F.3d 814, 817-818 (11th Cir. 2001); *Johnson v. West Suburban Bank*, 225 F.3d 366, 369 (3d Cir. 2000), cert. denied, 531 U.S. 1145 (2001).

[2] *See* pp. 15-16, below.

that is eventually determined to be void *ab initio*. This Court previously has recognized that an arbitration agreement may be enforced "even if the arbitration could not go forward as a class action. . ." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991) (internal quotation omitted). The New Jersey ruling conflicts with this Court's application of the FAA.

A plurality of this Court also stated in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), that where an arbitration agreement is silent as to whether the parties consent to class arbitration, an arbitrator must decide that issue. The Court's ruling implies that parties are free to permit or prohibit class arbitration. It would be improper, then, to strike the parties' statement of intent from the arbitration agreement, yet the New Jersey Supreme Court decision does so, interfering with the parties' right to contract according to their own terms. As the late Chief Justice Rehnquist, joined by Justices O'Connor and Kennedy in his dissent in *Bazzle*, stated, a state supreme court decision imposing class arbitration upon parties who impliedly provided otherwise "imposed a regime that was contrary to the express agreement of the parties" and thereby violated the FAA. 539 U.S. at 459 (Rehnquist, C.J., dissenting).

The Court also has held that a new law, or new interpretation of an existing law, should be applied only prospectively. *Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 208 (1988) ("Retroactivity is not favored in the law."). The New Jersey Supreme Court applied its "low value" distinction to arbitration agreements which, prior to its ruling, had not been unconscionable. Because this Court has held that a court may not automatically apply a change in the law retroactively where the application of that law attaches new legal consequences to completed, past conduct that was legal at the time, see *Usery v. Turner Elkhorn*

Mining Co., 428 U.S. 1, 15-16 (1976), the New Jersey ruling conflicts with this Court's precedent.

- **The conflict concerns a matter of overriding national importance. S. Ct. Rule 10(c).**

The New Jersey Supreme Court's decision in this case contravenes the central purpose of the FAA: enforcing arbitration agreements according to their terms. The conflict between New Jersey's new law and that of the majority of states has nationwide implications. Tens of thousands of standard commercial and consumer contracts contain arbitration provisions. In most of the rest of the country, courts enforce arbitration agreements as written, declining to rewrite them either to exclude an agreed upon class action waiver or include a class procedure to which the contracting parties did not agree. Thus, parties to standard contracts containing standard arbitration provisions face the prospect of starkly different proceedings arising from those contracts—all depending on whether they sue or are sued in New Jersey, or elsewhere.

In *Southland Corp. v. Keating*, *supra*, this Court noted probable jurisdiction to determine whether the California Supreme Court's ruling imposing a class action structure on an arbitration conflicted with the FAA. This Court concluded that it could not exercise jurisdiction over that question because it had not been raised adequately below. *Id.* at 9. The question left open in *Southland* still vexes the nation's lower courts and is squarely presented by this case. The conflict between the New Jersey Supreme Court's approach and that of most federal and state courts of appeal highlights a conflict that has only deepened in the intervening years—as is evidenced by the recent proliferation of petitions for certiorari on this and related issues. Certiorari should be granted to resolve, at last, this important question.

STATEMENT OF THE CASE

Jaliyah Muhammad ("Muhammad") sought out County Bank, a federally-insured, Delaware chartered depository institution, for a loan. App. B at 5. On or about April 28, 2003, she requested a short term, single advance, unsecured $ 200.00 loan. *Id.* at 6. To obtain the loan, County Bank's loan servicer, Main Street, faxed an application form to Muhammad, who completed, signed and faxed the completed application back to Main Street. *Id.*

After County Bank approved the loan, it transmitted funds directly to Muhammad's checking account via an ACH credit entry transaction. *Id.* at 7. Muhammad repeated this process for two additional loans, one on May 23, 2003 and another on June 6, 2003, each for $200.00. *Id.*

Muhammad's loans are evidenced by Note and Disclosure Statements ("Notes"). *Id.* The Notes clearly identify County Bank as the lender, a fact which Muhammad does not dispute. *Id.* at 5. Like the loan application, the Notes were received by facsimile, signed by Muhammad, and returned by facsimile to County Bank's loan servicer, Main Street. *Id.* at 6. The terms of the loans are clearly and prominently set forth in the Notes, including the annual percentage rate ("APR") and finance charge. *Id.* at 7.

The Notes also contain a choice of law clause providing that Delaware law governs the agreement and the relationship of the parties, except as federal law applies. App. H at 3. In addition, each of the Notes advised

Muhammad that County Bank had retained Main Street to service her loan. App. B. at 6.[3]

The Notes contain the following binding arbitration agreement above Muhammad's signature:

> AGREEMENT TO ARBITRATE ALL DISPUTES:
> You [the borrower] and we [County Bank] agree that any and all claims, disputes or controversies between you and us and/or the Company [defined as Main Street in the Notes], any claim by either of us against the other or the Company (or the employees, officers, directors, agents, or assigns of the other or the Company) and any claim arising from or relating to your application for this loan or any other loan you previously, now or may later obtain from us, this Loan Note, this agreement to arbitrate all disputes, your agreement not to bring, join or participate in class actions, regarding collection of the loan, alleging fraud or misrepresentation, whether under the common law or pursuant to federal, state or local statute, regulation or ordinance, including disputes as to the matters subject to arbitration, or otherwise, shall be resolved by binding individual (and not joint) arbitration by and under the Code of Procedure of the National Arbitration Forum ("NAF") in effect at the time the claim is filed. . . Your arbitration fees may be waived by the NAF in the event you cannot afford to pay them. The cost of any participatory, documentary or telephone hearing, if one is held at your or our request, will be paid for solely by us as provided in the NAF Rules and, if a participatory hearing is requested, it will take place at a

[3] Muhammad listed two County Bank trade names, "Easy Cash" and "Telecash" as defendants. County Bank used these trade names in connection with the advertising and marketing of its short term loans. However, the application and Notes clearly identify County Bank as the lender and Main Street as the servicer. App. B at 6.

location near your residence. This arbitration agreement is made pursuant to a transaction involving interstate commerce. It shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1-16. . .

App. B at 6. The arbitration agreement is followed by a notice, which appears in capital letters:

> NOTICE: YOU AND WE WOULD HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE DISPUTES THROUGH A COURT AND HAVE A JUDGE OR JURY DECIDE THE DISPUTES BUT HAVE AGREED INSTEAD TO RESOLVE DISPUTES THROUGH BINDING ARBITRATION.

Id.

In addition, the Note contains a separate agreement not to bring, join, or participate in class actions:

> *AGREEMENT NOT TO BRING, JOIN OR PARTICIPATE IN CLASS ACTIONS:* To the extent permitted by law, you agree that you will not bring, join or participate in any class action as to any claim, dispute or controversy you may have against us, our employees, officers, directors, servicers and assigns. You agree to the entry of injunctive relief to stop such a lawsuit or to remove you as a participant in the suit. You agree to pay the attorney's fees and court costs we incur in seeking such relief. This Agreement does not constitute a waiver of any of your rights and remedies to pursue a claim individually and not as a class action in binding arbitration as provided above.

Id.

Immediately above Muhammad's signature is the following notice, again printed in capital letters:

> BY SIGNING BELOW, YOU AGREE TO ALL OF THE TERMS OF THIS NOTE, INCLUDING THE AGREEMENT TO ARBITRATE ALL DISPUTES AND THE AGREEMENT NOT TO BRING, JOIN OR PARTICIPATE IN CLASS ACTIONS. YOU ALSO ACKNOWLEDGE RECEIPT OF A FULLY COMPLETED COPY OF THIS NOTE.

Id. at 6-7.

Although Muhammad agreed to arbitrate disputes and not to bring, join or participate in class actions, she filed a putative class action in New Jersey state court. *Id.* at 7. Arguing federal preemption, Petitioners timely removed the action from state court to federal court, but the case was remanded in June, 2004. *Id.*

The New Jersey Superior Court's Trial Division granted Petitioners' motion to stay proceedings and compel arbitration, after reviewing New Jersey case law and finding that, although the arbitration agreement was an adhesion contract, it could be enforced, including the class action waiver it contained.

The Superior Court's Appellate Division heard Muhammad's appeal and again ruled in favor of enforcing the arbitration agreement. The Appellate Division analyzed the plaintiff's unconscionability challenge in light of the four factors set forth by the New Jersey Supreme Court in *Rudbart v. North Jersey Dist. Water Supply Comm'n*, 127 N.J. 344, 353, 605 A.2d 681 (1992). Balancing the strong federal and New Jersey state policy favoring arbitration, the appellate court determined that the arbitration agreement was enforceable as written.

Rejecting plaintiff's argument that the class action waiver itself made the arbitration agreement unenforceable, the Appellate Division relied on *Gras v. Associates First Capital Corp.*, 346 N.J. Super. 42, 47, 786 A.2d 886 (App.Div. 2001), cert. denied, 171 N.J. 445, 794 A.2d 184 (2002), which had held that an arbitration agreement precluding class actions was not void as against the public policy of the state of New Jersey.

The New Jersey Supreme Court granted Muhammad leave to appeal. Overturning the two lower courts, the New Jersey Supreme Court found that an arbitration agreement containing a class action waiver was unconscionable and thus unenforceable in cases where small value claims might be brought.

The court distinguished *Gras* based on the fact that Muhammad's claim was considered one of a new class of "low value" claims that triggered the state law on unconscionability. The court did not set a dollar amount or other standard for determining in future cases whether a claim was large enough for *Gras'* holding to apply (as in the *Delta Funding Corp. v. Harris*, 2006 WL 2277984 (N.J. 2006) case decided by the court on the same day and reprinted here at App. D), or small enough for its holding in *Muhammad* to apply.

BASIS FOR GRANTING THE WRIT OF CERTIORARI

I. THE COURT SHOULD GRANT CERTIORARI TO DETERMINE WHETHER THE FAA PREEMPTS STATE-LAW RULES REQUIRING CLASS-ACTION PROCEDURES TO BE SUPERIMPOSED ON ARBITRATION.

Long before the state and federal conflicts over the enforceability of arbitration agreements reached as far and wide as they do today, this Court ordered briefing and argument on the question whether, if state law required "superimposing class-action procedures on a contract arbitration," it would conflict with the FAA and thus violate the Supremacy Clause. *Southland*, 465 U.S. at 8. In 1987, this Court concluded that it lacked jurisdiction to decide the issue because the appellant "did not contend in the California courts that, and the state courts did not decide whether, state-law imposing class-action procedures was pre-empted by federal law." *Id.*

Today the question is neither rhetorical nor hypothetical. The present case exemplifies the minority view on a long-simmering and important issue that now has created conflict among the states and the federal circuits. The question divides state courts within the same state, federal courts across the circuits, and even federal and state courts within the same circuit. This issue is of great importance not only to the petitioners, but also to all U.S. companies whose interaction with consumers may possibly fall within the new and nebulous sub-category of so-called "low value" claims.

Petitioners preserved this issue for review by raising the preemption argument as soon as the New Jersey Supreme Court issued an opinion contrary to the FAA. In their motion for reconsideration, Petitioners expressly questioned

whether the New Jersey Supreme Court's ruling was preempted in a motion for reconsideration. The motion for reconsideration is reprinted at App. F.

A. The New Jersey Supreme Court Ruling Conflicts With The Decisions Of Multiple Other Federal And State Courts, Including The Third Circuit.

The New Jersey Supreme Court's ruling that an arbitration agreement containing a class waiver is unconscionable in "low value" cases conflicts with other courts that have considered the issue. Among the state courts, California also has determined that an otherwise valid arbitration agreement containing a class action waiver is unconscionable in small consumer claims. *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 30 Cal. Rptr. 3d 76, 113 P.3d 1108 (2005). Supreme courts in Alabama, Illinois, and West Virginia have found arbitration clauses containing class action waivers invalid only where the arbitration clause contained other unfair provisions, such as limitations on claims, causes of action, or damages.[4] Appellate courts in Florida, Missouri, and Pennsylvania also have invalidated

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[4] *See Leonard v. Terminix International Co.*, 854 So.2d 529, 538-39 (Ala.2002) (striking clause that also limited recovery of damages); *Kinkel v. Cingular Wireless LLC*, 223 Ill.2d 1, 857 N.E.2d 250, 306 Ill.Dec. 157 (2006) (clause did not contain a provision under which the company would pay arbitration costs, did not provide for recovery of attorney's fees if permitted by applicable law and limited punitive damages); *State ex rel. Dunlap v. Berger*, 211 W.Va. 549, 567 S.E.2d 265 (W.Va. 2002) (prohibiting punitive damages), *cert. denied, sub nom., Friedman's, Inc. v. West Virginia ex rel. Dunlap*, 537 U.S. 1087 (2002).

agreements where the class waiver was accompanied by unfair limits on claims and damages.[5]

Most state courts to have considered this issue have upheld arbitration agreements containing class action waivers. State courts in Illinois[6] and Texas[7] have held, like the Tennessee Court of Appeals, that, regardless of any state-law concern about "the unavailability of class action relief," "the Supremacy Clause of the Federal Constitution. . . preclude[s] [a court] from invalidating an arbitration agreement otherwise enforceable under the FAA simply

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[5] *Powertel, Inc. v. Bexley*, 743 So.2d 570, 575-76 (Fla.App.1999), review denied, 763 So.2d 1044 (Fla. 2000) (company's liability limited only to actual damages, no provision allowing injunctive or declaratory relief as provided for in state statute); *Bellsouth Mobility LLC v. Christopher*, 819 So.2d 171, 173 (Fla.App. 2002) (same); *Whitney v. Alltel Communications, Inc.*, 173 S.W.3d 300, 313-14 (Mo.App.2005) (arbitration agreement required consumer to bear own costs, making it prohibitively expensive); *Thibodeau v. Comcast Corp.*, 2006 WL 3457582 (Pa.Super. 2006)(Nos. 2176 EDA 2005, 2117 EDA 2005) (one-sided clause effectively forced consumer to arbitrate but left access to court open to corporation).

[6] *Hutcherson v. Sears Roebuck & Company*, 342 Ill. App. 3d 109, 793 N.E. 2d 886 (Ill. App. 2003), rev. denied (class action waiver is not unconscionable under Arizona law, and FAA requires class action waiver to be enforced in accordance with its terms).

[7] *AutoNation USA Corporation v. Leroy*, 105 S.W. 3d 190 (Tex. 2003) (right to arbitrate under the FAA trumps right to maintain a class action).

because a plaintiff cannot maintain a class action." *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351, 365 (Tenn. Ct. App. 2001).[8]

State courts in Delaware, the District of Columbia, Hawaii, Kansas, Maine, Maryland, New York, and North Dakota, have determined, like the state of Colorado, that class action waivers are not unconscionable under state law. *Rains v. Foundation Health Systems Life & Health*, 2001 Colo. App. LEXIS 580 (Ct. App. Colo. Mar. 29, 2001)(No. 99CA2398,) No. 99CA2398 ("arbitration clauses are not unenforceable simply because they might render a class action unavailable").[9]

The federal courts of appeal split along roughly the same lines. The First Circuit and the Ninth Circuit have held that arbitration agreements containing class action waivers are unconscionable. *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003), cert. denied, 124 S. Ct. 53 (2003) (following California Court of Appeal's opinion in *Szetela v. Discover*

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[8] The Tennessee Supreme Court denied the plaintiff's petition for review in that case and ordered the state court of appeals decision published (63 S.W.3d at 351), which means that the decision "may be relied upon by the bench and bar of [Tennessee] as representing the present state of the law with the same confidence and reliability as the published opinions of [the Tennessee Supreme] Court." *Meadows v. State*, 849 S.W.2d 748, 752 (Tenn. 1993).

[9] *See Strand v. U.S. Bank National Ass'n* , 2005 ND 68, 693 N.W.2d 918, 926 (2005); *Walther v. Sovereign Bank*, 386 Md. 412, 438-42, 872 A.2d 735, 750-53 (2005); *Brown v. KFC National Management Co.*, 82 Haw.226, 921 P.2d 146 (1996); Stenzel v. Dell, Inc., 870 A.2d 133 (Me. 2005); *Forest v. Verizon Communications*, 805 A.2d 1007 (D.C.App. 2002) (upholding validity of forum selection clause despite unavailability of class actions in that forum); *Ranieri v. Bell Atlantic Mobile*, 759 N.Y.S.2d 448, 304 A.D.2d 353, app. denied, 1 N.Y. 3d 502, 807 N.E. 2d 290 (2003); *Pick v. Discover Financial Services*, 2001 WL 1180278 (D. Del. 2001)(No. 00-935-SLR).

Bank, 97 Cal. App. 4th 1094 (2002) and holding that class action waiver is unconscionable under California law); *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (finding recovery in antitrust case so small as to make class action waiver unconscionable).

In contrast, a federal district court in West Virginia recently rejected the state supreme court's holding that arbitration provisions containing class waivers are unconscionable when the damages sought are small, finding that holding to be preempted by the FAA. *Schultz v. AT&T Wireless Servs., Inc.*, 376 F. Supp. 2d 685, 691 (N.D. W.Va. 2005).

The Fifth[10] and Eleventh[11] Circuits, while not weighing in on the preemption issue specifically, reached the same conclusion by finding that state laws conditioning the enforceability of an arbitration provision on the availability of class-wide arbitration are incompatible with the objectives of arbitration.

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[10] *Iberia Credit Bureau*, 379 F.3d 159, 174 (quoting *Gilmer*, 500 U.S. at 31) ("the fact that certain litigation devices may not be available in an arbitration is part and parcel of arbitration's ability to offer 'simplicity, informality, and expedition,' characteristics that generally make arbitration an attractive vehicle for the resolution of low-value claims.").

[11] *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1378 (11th Cir. 2005) (quoting *Gilmer*, 500 U.S. at 31)(finding that prohibition of class arbitration is "consistent with the goals of 'simplicity, informality, and expedition' touted by the Supreme Court in *Gilmer*.").

The Second, Fourth, Sixth, Seventh, and Eighth federal Circuits have all found,[12] like the Third Circuit, that the procedural right to a class action is waivable, and that an arbitration agreement containing a class action waiver is fully enforceable. *Johnson v. West Suburban Bank*, 225 F.3d 366, 374 (3d Cir. 2000), s*ee Lloyd v. MBNA Am. Bank, N.A.*, 27 Fed. Appx. 82, 84 (3d Cir. 2002).

The *Johnson* opinion creates an extremely troubling conflict over the arbitration issue. Under *Johnson*, the class waiver in this case would be enforceable in a federal court sitting in New Jersey but, under *Muhammad*, is not enforceable in state courts there. That express conflict between the circuit and state courts invites forum shopping, and places companies in an untenable position: they cannot manage litigation risks because that risk will be solely determined by the court in which a potential case is brought.[13]

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[12] *JLM Industries, Inc. v. Stolt-Nielson SA*, 387 F.3d 163 (2nd Cir. 2004); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002); *Burden v. Check into Cash of Kentucky, LLC*, 267 F.3d 483 (6th Cir. 2001); *Caudle v. American Arbitration Association*, 2000 WL 1528950 (7th Cir. Oct. 17, 2000) (No. 00-1423), *In re Piper Funds, Inc.*, 71 F.3d 298 (8th Cir. 1995).

[13] This Court has long recognized that, "[i]f the federal court allows arbitration where the state court would disallow it, the outcome of litigation might depend on the courthouse where suit is brought." *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 203 (1956). The converse, of course, is equally true: Parties to a contract affecting interstate commerce may not avoid arbitration by filing their action in a state court when, had the action been brought in federal court, they would have been compelled to arbitrate. *See Burke Co. Public Sch. Board of Education v. Shaver Partnership*, 303 N.C. 408 (1981). To prevent such conflicts, Congress specifically imbued the FAA with preemptive force—where state and federal law would result in disparate rulings, the state burdening arbitration while federal law promotes it, the federal law must govern.

The forum shopping concern is only one of many reasons this issue is deeply important to companies who regularly contract with consumers. All entities, from cable and wireless service providers to finance and credit card companies, are at the mercy of state and federal courts, which may decide that the claims stemming from their service contracts are "low" enough to render their arbitration agreements unconscionable. In New Jersey alone, the issue is paramount. If a consumer with more loans than Muhammad were to bring a claim, it may or may not be large enough to merit enforceability under *Delta Funding* or *Muhammad*.

Petitioners, an out of state bank and a loan servicing company, are powerless to determine how the new rule will be applied, and even if they could determine how the New Jersey rule will be applied, they would not be able to consistently apply this rule outside of New Jersey. The New Jersey ruling forecasts 50 disparate state laws, each unique and potentially different from the law of the federal circuits sitting in those states, all amounting to a contracting and litigation nightmare for interstate commerce. Tens of millions of potential contracts, including thousands of County Bank's own agreements, are threatened as a result. *See* App. G (United States Chamber of Commerce, as *amici* to the New Jersey Supreme Court, discussing the impact on its 3,000,000 member businesses.)

B. The FAA Preempts New Jersey's Rule That Class Action Waivers Are Unconscionable In Low Value Cases.

The FAA "declared a national policy favoring arbitration and withdrew the power of the state to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10. "[M]otivated, first and foremost, by a

congressional desire to enforce agreements into which parties had entered," the Act was passed to "ensure judicial enforcement of privately made agreements to arbitrate," placing arbitration agreements "upon the same footing as other contracts." *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219, 220 (1985); *see Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (Arbitration Act's "central purpose" is "to ensure 'that private agreements are enforced according to their terms' ") (quoting *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989)).

To carry out the FAA's central purpose, state and federal courts are instructed to "rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation." *Dean Witter Reynolds*, 470 U.S. at 221 (quoting *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 20 (1983)); *Perry v. Thomas*, 482 U.S. 483, 489 (1987). And under the Supremacy Clause, state laws in conflict with the FAA's strong policy in favor of arbitration must give way. *See, e.g., Perry*, 482 U.S. at 484 (finding preempted a California law allowing certain actions to be maintained in court " 'without regard to the existence of any private agreement to arbitrate' ") (quoting Cal. Lab. Code Ann. § 229); *Southland*, 465 U.S. at 11-12 (finding preempted a California law interpreted by state courts to require judicial consideration of claims).

In declaring class arbitration waivers unenforceable in "low" value cases, the New Jersey Supreme Court placed its own policy preference for class actions squarely above Congress's policy of ensuring the enforcement of arbitration agreements as written. *See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995); *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 479 (1989); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-221 (1985). When state and

Congressional policies clash, Congress prevails. *Perry v. Thomas*, 482 U.S. 482, 491 (1987).

This Court also has made clear that state law is preempted whenever it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) (internal quotation marks omitted); *see also Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 869- 874 (2000); *United States v. Locke*, 529 U.S. 89, 109 (2000). New Jersey's rule conditioning enforcement of arbitration provisions on the value of the claim and whether class arbitration is permitted threatens Congress' primary objective in enacting the FAA and therefore is preempted because it applies *only* for the narrow class of terms or agreements relating to the procedures available to claimants in arbitration, and *only* to certain entities whose business may generate small dollar consumer claims.

The enforceability of an arbitration agreement does not and cannot depend on the value of the claims sought to be arbitrated. To subject arbitration agreements to such an *ad hoc* standard for enforceability, which is not generally applicable to other types of contracts, violates the FAA. *See Martindale v. Sandvik, Inc.*, 173 N.J. 76, 86 (N.J. 2002) (quoting *Ferry v. Thomas*, 482 U.S. at 492 n.9 (1987) ("[S]tate law. . . is applicable if that law arose to govern issues concerning the. . . enforceability of contracts generally." However, states may not "decide that a contract is fair enough to enforce all its basic terms . . . but not fair enough to enforce its arbitration clause" because "that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress' intent.").

The FAA permits states to enforce or reject arbitration agreements on "grounds as exist at law or in equity for the

revocation of any contract." 9 U.S.C. § 2. The unconscionability rule applied in this case, however, is not a ground that exists for any contract, but rather only for the arbitration agreements that waive class treatment, and only to certain entities whose business may generate claims falling within the newly created subcategory of cases that the New Jersey Supreme Court ambiguously named "low value consumer claims."

This arbitrary line between "low value" and "high value" loans will prove unworkable in practice, because it necessarily would invite courts to draw *post hoc*, arbitrary lines between claims that are substantial "enough" to merit individual arbitration and claims that are thought to be too small to justify it, and without knowing the size of claims to be asserted by other members of the putative class. Compare, *Muhammad* with *Delta Funding*; *see Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 282 (1995) (O'Connor, J., concurring) (emphasizing that courts should avoid interpreting FAA in a way that would "foster pre-arbitration litigation that would frustrate the very purpose of the statute"). If this line should be drawn, Congress is in the best position to draw it.

C. The Court Should Grant Certiorari To Resolve The Question It Previously Raised But Did Not Resolve in *Southland Corp. v. Keating*.

In *Keating v. Superior Court*, 645 P.2d 1192, 1195 (Cal. 1982), the plaintiff franchisees brought a class action against their franchisor alleging numerous state law claims. The trial court granted Southland's motion to compel arbitration of the plaintiffs' claims and ordered that the arbitration proceed as a "class arbitration"—even though the parties' agreement did not specify that a class procedure was available in arbitration. The California Supreme Court

granted review of the question whether the trial court could impose class action procedures on the parties. Advancing the same policy rationales the New Jersey Supreme Court identified in this case, the California Supreme Court concluded that the arbitration could go forward as a class proceeding, if the trial court concluded on remand that "gross unfairness" would otherwise result. *Id.* at 1209. Three dissenting justices observed that "[a]rbitration is a matter of agreement," and that the parties' arbitration contracts "do not provide for class arbitration, nor have the parties subsequently agreed thereto." *Id.* at 1214.

This Court noted probable jurisdiction over the question "whether arbitration under the federal Act is impaired when a class-action structure is imposed on the process by the state courts." *Southland*, 465 U.S. at 3. This Court ultimately dismissed that question for lack of jurisdiction, finding that the class arbitration procedure had been challenged below on state law grounds only. *Id.* at 9.

This case raises the same question left unanswered in *Southland*, with two significant twists. First, the parties' arbitration agreement in *Southland* was silent as to whether class action procedures were available in arbitration. In contrast, County Bank's arbitration agreement with Muhammad ***expressly precluded*** class action procedures. Second, the court determined that this revision was appropriate only in consumer cases likely to generate "low value" claims. Thus, for companies doing business in New Jersey, class waivers are available only if the companies' interaction with consumers does not generate "low value" claims, notwithstanding what the parties' agreement actually provides. Only if the claim is large enough – and "large enough" is to be determined case by case with no guidance – will the parties be permitted to arbitrate their claims as agreed.

The jurisdictional impediments to review in *Southland* do not exist here. The question whether the FAA precludes the state court from writing class procedures into the parties' arbitration agreement was raised below on a motion for reconsideration – the first opportunity to do so.[14]

II. THE NEW JERSEY SUPREME COURT'S RULING DENIES PETITIONERS DUE PROCESS BY RETROACTIVELY ENFORCING A NEW INTERPRETATION OF NEW JERSEY LAW.

In *Muhammad*, the New Jersey Supreme Court articulated a new legal principle and applied it retroactively to the Petitioners, thus violating Petitioners' procedural due process rights. In its Opinion, the New Jersey Supreme Court expressly noted that the issue of class arbitration "specifically has never before been examined by this Court." App. A at 17-18.

New Jersey law prior to *Muhammad* held that a waiver of certain rights in an arbitration clause would be enforced so long as they were sufficiently notorious and specific. *Gras v. Associates First Capital Co.*, 346 N.J. Super. 42, 49-57 (App. Div. 2001), *cert. denied*, 171 N.J. 445 (2002). As shown above, pp. 8-9, the provisions here were both specific and notorious. In *Muhammad*, the Court created a new rule that distinguished between "low value" and "high value" claims in determining that a class arbitration waiver is unconscionable and unenforceable when it involves an undefined small amount of money. Meanwhile, a separate ruling on the same day in *Delta Funding*, *supra*, held that such waivers *were* enforceable and not unconscionable when

[14] Prior to the New Jersey Supreme Court's ruling, the lower trial courts had ruled in compliance with the FAA, and no preemption question existed.

they involved a larger monetary claim. App D at 10. Prior to *Muhammad* and *Delta Funding*, New Jersey law did not differentiate between "low value" and "high value" claims.

If applied at all, the new distinction cannot be applied retroactively to the parties here because to do so would cause manifest injustice. "Retroactivity is not favored in the law." *Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 208 (1988), *see* H. Broom, Legal Maxims 24 (8th ed. 1911) ("Retrospective laws are, as a rule, of questionable policy, and contrary to the general principle that legislation by which the conduct of mankind is to be regulated ought to deal with future acts, and ought not to change the character of past transactions carried on upon the faith of the then existing law"). Federal law establishes that there are explicit and implied limitations on the legislature's power to impose laws retroactively. Article I, Section 10 of the U.S. Constitution provides that "[n]o State shall. . . pass any. . . law impairing the obligation of contracts." Just as legislatures are barred, so are the courts. All statutes with retroactive elements are subject to scrutiny under the due process clause of the Fourteenth Amendment of the U.S. Constitution. U.S. Const. amend. XIV, § 1.

A court may not automatically apply a change in the law retroactively where the application of that law attaches new legal consequences to completed, past conduct that was legal at the time. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15-16 (1976). If a decision establishes a new principle of law by overruling past precedent or by deciding an issue of first impression, it should be applied only prospectively. *Coons v. American Honda Motor Co.*, 96 N.J. 419, 427, 476 A.2d 763 (1984), cert. denied, 469 U.S. 1123, 105 S.Ct. 808, 83 L.Ed.2d 800 (1985).

If allowed to stand, the Court's ruling in *Muhammad* will effectively invalidate thousands of existing contracts in

which the parties expressly waived certain rights to court proceedings and class actions. The decision also impacts every lender and merchant offering credit cards to New Jersey residents on the basis of the protection provided by the previous law and their legally valid agreements. Retail sales companies and basic service providers are laid open to massive unplanned litigation risk. Such a sweeping application of a fact-specific analysis is arbitrary and irrational and cannot be the basis for retroactive application. *Usery*, *supra*, 428 U.S. at 15.

The ruling in *Muhammad* goes far beyond imposing additional, unnegotiated obligations on Petitioners. It imposes terms that directly contradict the express agreement of the parties. A retrospective application of the ruling in *Muhammad* will result in lengthy and expensive litigation that was not anticipated by either party at the time of entering into the contract, and it will have the chilling effect of discouraging other businesses from lending in this so-called "low value" arena, an area in which customers arguably need additional options, not fewer.

III. THE RULING BELOW UNDULY BURDENS INTERSTATE COMMERCE BY SEEKING TO IMPOSE DISPARATE REQUIREMENTS ON ARBITRATION AGREEMENTS MADE IN THE INTERSTATE MARKET.

Section 2 of the FAA declares pre-dispute arbitration agreements "valid, irrevocable, and enforceable" because "arbitration saves time, saves trouble, saves money." Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong., 1st Sess. 7 (1924) (statement of Charles Bernheimer, N.Y. Chamber of Commerce); *see also* H.R. Rep. No. 68-96, at 2 (1924) ("the costliness and delays of litigation. . .can be largely eliminated by agreements for arbitration, if arbitration

agreements are made valid and enforceable"). As Congress later explained, arbitration usually is "cheaper and faster than litigation," has "simpler procedural and evidentiary rules," "minimizes hostility," and is "more flexible in regard to scheduling." H.R. REP. No. 97-542, at 13 (1982). This Court, too, has recognized the superior "simplicity, informality, and expedition of arbitration." *Mitsubishi Motors Corp. v. Soler ChryslerPlymouth, Inc.*, 473 U.S. 614, 628 (1985); *see also Dean Witter*, 470 U.S. at 221 (recognizing that twin goals of FAA are "enforcement of private agreements [to arbitrate] and encouragement of efficient and speedy dispute resolution").

Class-action procedures, by contrast, severely hinder the low-cost and efficient resolution of disputes that is the hallmark of arbitration. Class actions first require a lengthy class certification proceeding. If, after extensive discovery and hearings, a class is certified, there must be full and adequate notice to class members and an opportunity to opt out. Discovery commensurate with the now-increased stakes of the litigation begins next and often continues for years. If the defendant settles to curtail increasing costs, another round of notice followed by a fairness hearing, complete with extensive briefing by both sides and by any objectors then follows. If the defendant chooses not to settle, a class-wide trial follows - one in which the parties must present the common and individualized elements of their claims and defenses.

Forcing Petitioners to defend against the time-consuming and expensive class action procedures over a previously negotiated waiver of those proceedings eliminates the distinction between arbitration and litigation, but also presents businesses with an impossible scenario. While class arbitration would increase the stakes exponentially over an individual arbitration, any classwide arbitral award would remain reviewable only for fraud, corruption or bias, see 9

U.S.C. § 10, or "manifest disregard" of the law, see *Wilko v. Swan*, 346 U.S. 427, 436-437 (1953), overruled on other grounds by *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989).

This standard of review often will be insufficient to avoid an erroneous, yet potentially massive, class-wide judgment. Precluding class waivers also is contrary to the goals of the arbitration process – to provide an efficient and cost effective way to resolve disputes. As Justice Thomas has explained, a rule that "discourages the use of arbitration agreements" is "completely inconsistent with the policies underlying the FAA." *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 310 (2002) (Thomas, J., dissenting); *see also Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 175-176 (5th Cir. 2004) (for parties to demand "all of the procedural accoutrements that accompany a judicial proceeding" would undermine "the point of arbitration").

By eliminating the class waiver from thousands of County Bank contracts, New Jersey's rule disproportionately burdens arbitration and hence violates the Commerce Clause. *Cf. Best & Co. v. Maxwell*, 311 U.S. 454, 455 (1940) ("The commerce clause forbids discrimination, whether forthright or ingenious."). Should the current conflict in the law persist, the enforceability of form contracts containing arbitration provisions will vary from state to state based on the *ad hoc* policy judgments of the various states' courts as to whether the arbitration provision (or some feature of it) shocks the conscience. In fact, as demonstrated here, enforceability of the same form contract could differ in different cases within the same state, should the state choose to draw additional lines between types of claims (as here), or types of consumers, or types of services.

The uncertainty created by New Jersey's *ad hoc*, state specific approach is a burden not just on arbitration, but also

on interstate commerce. *See BMW of North America, Inc. v. Gore*, 517 U.S. 559, 570-571 ("[O]ne state's power to impose burdens on the interstate market [through a state court's actions in a civil case]. . .is not only subordinate to the federal power over interstate commerce, but is also constrained by the need to respect the interests of other states.") (internal citations omitted). This Court has long stated that the Constitution is equally concerned with state regulation and Congressional regulation of interstate commerce, *see Healy v. Beer Institute*, 491 U.S. 324, 335-336 (1989), but that state regulation attempting to upset that balance must give way to the FAA. *See Southland*, 465 U.S. at 15 ("We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted.").

The New Jersey rule disproportionately burdens arbitration and interstate commerce and must not be allowed to stand. Only Congress, not individual states, has the power to do so.

CONCLUSION

State and federal courts have been seeking resolution to the arbitration questions presented in *Muhammad* for 20 years since this Court raised the preemption question in *Southland*. Certiorari should now be granted and the decision of the New Jersey Supreme Court should be reversed so that the multi-level conflicts, *ad hoc* adjudication, and upheaval in interstate commerce may end, allowing arbitration to move forward as Congress originally intended.

Respectfully submitted,

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APPENDIX A

Muhammad v. County Bank of Rehoboth Beach, DelawareN.J.,2006.--- A.2d ----Only the Westlaw citation is currently available.

Supreme Court of New Jersey.

Jaliyah MUHAMMAD, on her own behalf and all others similarly situated, Plaintiff-Appellant,

v.

COUNTY BANK OF REHOBOTH BEACH, DELAWARE and Main Street Service Corporation, Defendants-Respondents,

andEasycash, Telecash, John Doe and John Roe, Defendants.

Argued Feb. 14, 2006.

Decided Aug. 9, 2006.

SYNOPSIS

Background: Borrower brought class action against lender and servicer of payday loan, alleging that all defendants violated the New Jersey Consumer Fraud Act, the servicer violated usury law and the New Jersey Racketeer Influenced and Corrupt Organizations Act (RICO), and the lender conspired to violate RICO. Defendants moved to compel arbitration. The Superior Court, Law Division, Union County, granted motion. Borrower appealed, and the Superior Court, Appellate Division, affirmed, 379 N.J.Super. 222, 877 A.2d 340. Borrower appealed.

Holdings: The Supreme Court, LaVecchia, J., held that:

(1) court, rather than arbitrator, was required to determine whether class-action arbitration waiver in loan agreement was valid;

(2) challenge was not a challenge to the contract as a whole but rather was a specific challenge to the arbitration agreement;

(3) as a matter of first impression, class-arbitration waiver contained in arbitration agreement was unconscionable due to public interest at stake; and

(4) class-arbitration waivers were severable such that remainder of the arbitration agreements were enforceable.

Reversed and remanded.

Rivera-Soto, J., concurred in part and dissented in part with opinion.

[1] Alternative Dispute Resolution 25T 134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability.
Most Cited Cases
The Federal Arbitration Act (FAA) does not preclude an examination into whether the arbitration agreement at issue is unconscionable under state law. 9 U.S.C.A. § § 1 et seq.

[2] Alternative Dispute Resolution 25T 134(3)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(3) k. Validity of Assent.

Most Cited Cases

Alternative Dispute Resolution 25T ⚿134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability. Most Cited Cases
Generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening the Federal Arbitration Act (FAA). 9 U.S.C.A. § 2.

[3] Alternative Dispute Resolution 25T ⚿199

25T Alternative Dispute Resolution

25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk197 Matters to Be Determined by Court
25Tk199 k. Existence and Validity of Agreement. Most Cited Cases
The issue of whether the parties have a valid arbitration agreement at all is a gateway question that requires judicial resolution.

[4] Alternative Dispute Resolution 25T ⚿202

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk197 Matters to Be Determined by Court

25Tk202 k. Waiver, Laches, or Estoppel.
Most Cited Cases
Court, rather than arbitrator, was required to determine whether class-action arbitration waiver in loan agreement was valid, as agreement was not silent or even ambiguous as to the availability of class arbitration.

[5] Alternative Dispute Resolution 25T 199

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk197 Matters to Be Determined by Court
25Tk199 k. Existence and Validity of Agreement. Most Cited Cases
A court must decide whether an agreement to arbitrate is valid.

[6] Alternative Dispute Resolution 25T 202

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk197 Matters to Be Determined by Court
25Tk202 k. Waiver, Laches, or Estoppel. Most Cited Cases
Borrower's challenge to class-action arbitration waiver in loan agreement was not a challenge to the contract as a whole, but rather was a specific challenge to the arbitration agreement such that court, rather than arbitrator, could decide validity of waiver; based on their location and subject matter, distinct class-arbitration waivers within arbitration clauses of both loan note and disclosure form and the loan application were part of the arbitration agreements, and not part of the contracts as a whole.

[7] Contracts 95 ⚿1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
Courts may refuse to enforce contracts that are unconscionable.

[8] Contracts 95 ⚿1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
The determination that a contract is one of adhesion is the beginning, not the end, of the inquiry into whether a contract, or any specific term therein, should be deemed unenforceable based on policy considerations.

[9] Contracts 95 ⚿1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
A sharpened inquiry concerning unconscionability is necessary when a contract of adhesion is involved.

[10] Parties 287 ⚿35.1

287 Parties
287III Representative and Class Actions
287III(A) In General

287k35.1 k. In General. Most Cited Cases
The class-action mechanism is valuable to litigants, to the courts, and to the public interest.

[11] Alternative Dispute Resolution 25T 134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability. Most Cited Cases

Contracts 95 1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
Class-arbitration waiver contained in arbitration agreement in payday loan adhesion contract was unconscionable due to public interest at stake, as class-arbitration bar effectively prevented borrower from pursuing her consumer protection rights and shielded lenders from compliance with state law; action involving complicated financial arrangements and multiple out-of-state entities, and damages amount sought by borrower added up to maximum of less $600. N.J.S.A. 31:1-1, 56:8-2.

Class-arbitration waiver contained in arbitration agreement in payday loan adhesion contract was unconscionable due to public interest at stake, as class-arbitration bar effectively prevented borrower from pursuing her consumer protection rights and shielded lenders from compliance with state law; action involving complicated financial arrangements and

multiple out-of-state entities. and damages amount sought by borrower added up to maximum of less $600. N.J.S.A. 31:1-1. 56:8-2.

[12] Contracts 95 ⚿1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
Adhesive consumer contracts which are ordinarily enforceable nonetheless may rise to the level of unconscionability when substantive contractual terms and conditions impact public interests adversely.

[13] Contracts 95 ⚿114

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k114 k. Exemption from Liability. Most Cited Cases

Exculpatory waivers that seek a release from a statutorily imposed duty are void as against public policy.

[14] Contracts 95 ⚿1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
Class-action waivers are problematic when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably

involve small amounts of damages.

[15] Contracts 95 🔑1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
When substantial damages are at stake, the court considering the validity of a class-action waiver in a contract of adhesion should consider whether the availability of attorney's fees, including any possible fee enhancement, in conjunction with a substantial potential damages award, including any potential statutory multipliers, would allow a substantial number of consumers to obtain counsel and seek relief such that the waiver would be valid.

[16] Alternative Dispute Resolution 25T 🔑111

25T Alternative Dispute Resolution
25TII Arbitration
25TII(A) Nature and Form of Proceeding
25Tk111 k. Nature, Purpose, and Right to Arbitration in General. Most Cited Cases
The purpose of arbitration is not to discourage consumers from seeking vindication of their rights.

[17] Alternative Dispute Resolution 25T 🔑140

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk140 k. Severability. Most Cited Cases
Unconscionable class-arbitration waivers in arbitration agreements contained in payday loan adhesion contracts were severable such that remainder of the arbitration

agreements were enforceable, as use of language "to the extent permitted by law" in broad class-action waivers indicated intention that arbitration agreement would be implemented whether and to whatever extent class-wide arbitration might be barred.

[18] Alternative Dispute Resolution 25T 140

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk140 k. Severability. Most Cited Cases
If all the provisions of the arbitration clause are enforceable, then the court must compel arbitration according to the terms of the agreement; if, however, some or all of its provisions are not enforceable, then the court must determine whether the unenforceable provisions are severable.

[19] Alternative Dispute Resolution 25T 140

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk140 k. Severability. Most Cited Cases
Severability of unenforceable portions of an arbitration agreement is decided as a matter of state law.

[20] Alternative Dispute Resolution 25T 140

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk140 k. Severability. Most Cited Cases
If the offensive terms of an arbitration agreement are severable, then the court must compel arbitration according to the remaining, valid terms of the parties' agreement; the court should deny a motion to compel arbitration only where

the invalid terms of the arbitration clause render the entire clause void as a matter of state law.

On appeal from Superior Court, Appellate Division, whose opinion is reported at 379 N.J.Super. 222, 877 A.2d 340 (2005).

Michael J. Quirk, a member of the New York and District of Columbia bars, argued the cause for appellant (Trujillo, Rodriguez & Richards and Williams, Cuker & Berezofsky, attorneys; Mr. Quirk, Donna Siegel Moffa and Mark R. Cuker, on the briefs).

Marc J. Zucker and Claudia T. Callaway, a member of the District of Columbia bar, argued the cause for respondents (Weir & Partners, attorneys for County Bank of Rehoboth Beach, Delaware and Sweeney & Sheehan, attorneys for Main Street Service Corporation; Mr. Zucker, Ms. Callaway, Susan M. Verbonitz, John Michael Kunsch, on the briefs).
David G. McMillin argued the cause for amicus curiae Legal Services of New Jersey (Melville D. Miller, Jr., President, attorney; Mr. McMillin, Mr. Miller and Christopher Hill, on the brief).
Jeffrey C. Burstein, Assistant Attorney General, argued the cause for amici curiae Attorney General of New Jersey and The New Jersey Division of Consumer Affairs (Zulima V. Farber, Attorney General, attorney; Mr. Burstein and Carol G. Jacobson, Deputy Attorney General, on the brief).
David M. Gossett, a member of the Illinois and District of Columbia bars, argued the cause for amicus curiae Chamber of Commerce of the United States of America (Drinker Biddle & Reath, attorneys; Mr. Gossett, Evan M. Tager, a member of the New York and District of Columbia bars, Robin S. Conrad, a member of the District of Columbia bar, Amar D. Sarwal, a member of the District of Columbia bar, of counsel; Andrew B. Joseph, on the brief).

William J. Pinilis submitted a brief on behalf of amici curiae AARP, Consumers League of New Jersey and National Association of Consumer Advocates.

Marvin J. Brauth and Jeffrey J. Brookner submitted a brief on behalf of amicus curiae New Jersey Business and Industry Association (Wilentz, Goldman & Spitzer, attorneys; Mr. Brauth, of counsel; Mr. Brauth and Mr. Brookner, on the brief).*Michael J. Quirk,* a member of the New York and District of Columbia bars, argued the cause for appellant (*Trujillo, Rodriguez & Richards* and *Williams, Cuker & Berezofsky,* attorneys; *Mr. Quirk, Donna Siegel Moffa* and *Mark R. Cuker,* on the briefs).*Marc J. Zucker* and *Claudia T. Callaway,* a member of the District of Columbia bar, argued the cause for respondents (*Weir & Partners,* attorneys for County Bank of Rehoboth Beach, Delaware and *Sweeney & Sheehan,* attorneys for Main Street Service Corporation; *Mr. Zucker, Ms. Callaway, Susan M. Verbonitz, John Michael Kunsch,* on the briefs).*David G. McMillin* argued the cause for amicus curiae Legal Services of New Jersey (*Melville D. Miller, Jr.,* President, attorney; *Mr. McMillin, Mr. Miller* and *Christopher Hill,* on the brief).*Jeffrey C. Burstein,* Assistant Attorney General, argued the cause for amici curiae Attorney General of New Jersey and The New Jersey Division of Consumer Affairs (*Zulima V. Farber,* Attorney General, attorney; *Mr. Burstein* and *Carol G. Jacobson,* Deputy Attorney General, on the brief).*David M. Gossett,* a member of the Illinois and District of Columbia bars, argued the cause for amicus curiae Chamber of Commerce of the United States of America (*Drinker Biddle & Reath,* attorneys; *Mr. Gossett, Evan M. Tager,* a member of the New York and District of Columbia bars, *Robin S. Conrad,* a member of the District of Columbia bar, *Amar D. Sarwal,* a member of the District of Columbia bar, of counsel; *Andrew B. Joseph,* on the brief).*William J. Pinilis* submitted a brief on behalf of amici curiae AARP, Consumers League of New Jersey and National Association of Consumer Advocates.*Marvin J. Brauth* and *Jeffrey J. Brookner* submitted a brief on behalf of

amicus curiae New Jersey Business and Industry Association (*Wilentz, Goldman & Spitzer,* attorneys; *Mr. Brauth,* of counsel; *Mr. Brauth and Mr. Brookner,* on the brief).

Justice LaVECCHIA delivered the opinion of the Court.

*1 In this appeal we must determine whether a provision in an arbitration agreement that is part of a consumer contract of adhesion is unconscionable and therefore unenforceable because it forbids class-wide arbitration. Plaintiff entered into a short-term loan agreement, the terms of which she claims violate the State's consumer-fraud statutes. Her complaint includes allegations that the State's civil usury limits are being evaded in loan transactions such as hers by means of a conspiracy involving complex financial dealings among out-of-state financial entities. The damages allegedly caused by such transactions are small on an individual-by-individual basis, but are substantial when aggregated into a class claim. Plaintiff seeks, therefore, to pursue a class action and is willing to pursue her class-wide claim in the arbitral forum but for the arbitration agreement's class-arbitration bar. Both the trial court and the Appellate Division found the class-arbitration bar enforceable.

Applying the controlling test for determining unconscionability for contracts of adhesion set forth in *Rudbart v. North Jersey District Water Supply Commission,* 127 *N.J.* 344, 605 *A.*2d 681, *cert. denied,* 506 *U.S.* 871, 113 *S.Ct.* 203, 121 *L. Ed.*2d 145 (1992), we hold that the class-arbitration waiver in this consumer contract is unenforceable. Such a waiver would be unconscionable whether applied in a lawsuit or in arbitration. We further conclude that the appropriate remedy in these circumstances is to sever the unconscionable provision and enforce the otherwise valid arbitration agreement.

I.

Defendant County Bank of Rehoboth Beach, Delaware (County Bank) is a federally-insured depository institution chartered under Delaware law. Defendant Main Street Service Corp. (Main Street) is a loan servicer for County Bank. Main Street operates a telephone service center in Pennsylvania. Defendants Easy Cash and Telecash are registered trade names of County Bank.

On May 23, 2003, plaintiff Jaliyah Muhammad, a part-time student at Berkeley College in Paramus, received a short-term, single advance, unsecured loan of $200 from County Bank. According to the terms of the LOAN NOTE AND DISCLOSURE form that Muhammad signed, the principal, along with a finance charge of sixty dollars, was due on June 13, 2003. The annual percentage rate listed on the loan note was 608.33%. According to Muhammad, she twice extended the loan (with a sixty dollar finance charge each time) because she could not repay it, resulting in a total of $180 in finance charges. Those facts are unchallenged by defendants. Muhammad also obtained two similar loans from County Bank, dated April 28, 2003 and June 6, 2003.

Muhammad had to complete and return three pages of standard form contracts in order to receive a loan. The first two pages, entitled "LOAN APPLICATION," were signed by Muhammad on April 28, 2003. Muhammad did not have to complete that form again in connection with the loans made on May 23, 2003 and June 6, 2003. The first page of the LOAN APPLICATION requested general personal information. The second page contained the relevant provisions concerning arbitration:

*2 AGREEMENT TO ARBITRATE ALL DISPUTES: By signing below and to induce us, County Bank of Rehoboth Beach, Delaware, to process your application for a loan, you and we agree that any and all claims, disputes or

controversies that we or our servicers or agents have against you or that you have against us, our servicers, agents, directors, officers and employees, that arise out of your application for a loan, the Loan Note or Agreement that you must sign to obtain the loan, this agreement to arbitrate all disputes, collection of the loan, or alleging fraud or misrepresentation, whether under the common law or pursuant to federal or state statute or regulation, including the matters subject to arbitration, *or otherwise, shall be resolved by binding individual (and not class) arbitration* by and under the Code of Procedures of the National Arbitration Forum ("NAF") in effect at the time the claim is filed. This agreement to arbitrate all disputes shall apply no matter by whom or against whom the claim is filed....

NOTICE: YOU AND WE WOULD HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE DISPUTES THROUGH A COURT AND HAVE A JUDGE OR JURY DECIDE THE DISPUTES BUT HAVE AGREED INSTEAD TO RESOLVE DISPUTES THROUGH BINDING ARBITRATION.

AGREEMENT NOT TO BRING, JOIN OR PARTICIPATE IN CLASS ACTIONS: To the extent permitted by law, by signing below you agree that you will not bring, join or participate in any class action as to any claim, dispute or controversy you may have against us or our agents, servicers, directors, officers and employees. You agree to the entry of injunctive relief to stop such a lawsuit or to remove you as a participant in the suit. You agree to pay the costs we incur, including our court costs and attorney's fees, in seeking such relief. This agreement is not a waiver of any of your rights and remedies to pursue a claim individually and not as a class action in binding arbitration as provided above. This agreement not to bring or participate in class action suits is an independent agreement and shall survive the closing and repayment of the loan for which you are applying.

[(Emphasis added).]

Above the signature line, the LOAN APPLICATION also stated that "[b]y signing below you also agree to the Agreement to Arbitrate All Disputes and the Agreement Not To Bring, Join or Participate In Class Actions...."

In respect of the May 23, 2003 loan, Muhammad also executed a LOAN NOTE AND DISCLOSURE form that included the following language.

AGREEMENT TO ARBITRATE ALL DISPUTES: You and we agree that any and all claims, disputes or controversies between you and us and/or the Company, any claim by either of us against the other or the Company (or the employees, officers, directors, agents or assigns of the other or the Company) and any claim arising from or relating to your application for this loan or any other loan you previously, now or may later obtain from us, this Loan Note, this agreement to arbitrate all disputes, your agreement not to bring, join or participate in class actions, regarding collection of the loan, alleging fraud or misrepresentation, whether under the common law or pursuant to federal, state or local statutes, regulation or ordinance, including disputes as to the matters subject to arbitration, or otherwise, *shall be resolved by binding individual (and not joint) arbitration* by and under the Code of Procedure of the National Arbitration Forum ("NAF") in effect at the time the claim is filed. This agreement to arbitrate all disputes shall apply no matter by whom or against whom the claim is filed.... This arbitration agreement is made pursuant to a transaction involving interstate commerce. It shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1-16....

***3** NOTICE: YOU AND WE WOULD HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE DISPUTES THROUGH A COURT AND HAVE A JUDGE OR JURY DECIDE THE DISPUTES BUT HAVE AGREED INSTEAD TO RESOLVE DISPUTES THROUGH BINDING ARBITRATION.

AGREEMENT NOT TO BRING, JOIN OR PARTICIPATE

IN CLASS ACTIONS: To the extent permitted by law, you agree that you will not bring, join or participate in any class action as to any claim, dispute or controversy you may have against us, our employees, officers, directors, servicers and assigns. You agree to the entry of injunctive relief to stop such a lawsuit or to remove you as a participant in the suit. You agree to pay the attorney's fees and court costs we incur in seeking such relief. This Agreement does not constitute a waiver of any of your rights and remedies to pursue a claim individually and not as a class action in binding arbitration as provided above.
[(Emphasis added).]

If that were not clear enough, directly above the signature line, the LOAN NOTE AND DISCLOSURE form also stated, that "BY SIGNING BELOW, YOU AGREE TO ALL OF THE TERMS OF THIS NOTE, INCLUDING THE AGREEMENT TO ARBITRATE ALL DISPUTES AND THE AGREEMENT NOT TO BRING, JOIN OR PARTICIPATE IN CLASS ACTIONS."

Thus, the contracts signed by Muhammad contain two types of class-action prohibitions. The first, referred to herein as the "class-arbitration waivers," are found within the text of the arbitration clauses and highlighted above. They specifically bar class claims in arbitration. The second, referred to herein as the "broad class-action waivers," are separate from the arbitration clauses and prohibit Muhammad from bringing or participating in class-action suits brought in court as well as class claims brought in arbitration.

In February 2004, Muhammad filed a putative class-action suit in New Jersey Superior Court against County Bank, Easy Cash, Telecash, Main Street, John Doe, and John Roe. The complaint alleged that Easy Cash, Telecash, and Main Street violated the Consumer Fraud Act (CFA), *N.J.S.A.*

56:8-2, the civil usury statute, *N.J.S.A.* 31:1-1, and the New Jersey RICO statute, *N.J.S.A.* 2C:41-1, by charging, and conspiring to charge, illegal rates of interest. The complaint further alleged that County Bank aided and abetted the unlawful conduct of the other defendants by renting out its name and status without actually funding or meaningfully participating in the loans. Muhammad requested injunctive relief, restitution, damages, penalties, and costs.

Defendants removed the action to federal district court, but because Muhammad's claims were determined by that court not to be preempted by the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 *U.S.C.* § 1831d, the case was remanded to state court. Defendants thereupon filed a motion to compel arbitration and to stay the action pending arbitration. They also filed a motion requesting a protective order in respect of discovery. Muhammad opposed defendants' motions and filed a cross-motion concerning discovery. Muhammad argued that the arbitration agreement was unconscionable based on the class-action waiver, discovery limitations in NAF's rules, the costs of the arbitration, and the bias inherent in NAF as an arbitration forum.[FN1] In response, defendants offered to arbitrate Muhammad's claims in the American Arbitration Association rather than the NAF-an offer that Muhammad rejected.

***4** The trial court granted defendants' motion to compel arbitration pursuant to the Federal Arbitration Act (FAA), 9 *U.S.C.* § 4, and stayed the case pending arbitration. Muhammad filed a motion for leave to appeal, which was granted. In a published decision, the Appellate Division affirmed the trial court. *Muhammad v. County Bank of Rehoboth Beach*, 379 *N.J.Super.* 222, 877 *A.*2d 340 (App.Div.2005). Applying *Rudbart, supra*, 127 *N.J.* at 353, 605 *A.*2d 681, the panel concluded that the arbitration agreement was not unconscionable. *Muhammad, supra*, 379

N.J.Super. at 237-48, 877 *A.*2d 340. In upholding the class-arbitration bar specifically, the Appellate Division relied on its earlier decision in *Gras v. Associates First Capital Corp.*, 346 *N.J.Super.* 42, 786 *A.*2d 886 (2001), *certif. denied*, 171 *N.J.* 445, 794 *A.*2d 184 (2002), which, the panel believed, "directly address[ed]" the class-action waiver issue. *Muhammad, supra*, 379 *N.J.Super.* at 244-48, 877 *A.*2d 340. Judge Kestin filed a separate concurring opinion. *Id.* at 249, 877 A.2d 340.

Plaintiff filed a motion for leave to appeal, which we granted. 185 *N.J.* 254 (2005). Legal Services of New Jersey filed a brief as amicus curiae in support of Muhammad. AARP, the Consumers League of New Jersey, and the National Association of Consumer Advocates filed a joint brief in support of Muhammad. Also, the Attorney General on behalf of the New Jersey Division of Consumer Affairs filed a brief in Muhammad's support. The Chamber of Commerce of the United States of America and the New Jersey Business and Industry Association filed amicus briefs in support of defendants.

II.

A.

[1] Congress enacted the FAA, 9 *U.S.C.* § § 1-16, "to abrogate the then-existing common law rule disfavoring arbitration agreements 'and to place arbitration agreements upon the same footing as other contracts.' " *Martindale v. Sandvik, Inc.*, 173 *N.J.* 76, 84, 800 *A.*2d 872 (2002) (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 *U.S.* 20, 24, 111 *S.Ct.* 1647, 1651, 114 *L. Ed.*2d 26, 36 (1991)). Section 2 of the FAA provides that arbitration agreements covered by the Act "shall be valid, irrevocable, and enforceable save

upon grounds as exist at law or in equity for the revocation of any contract." 9 *U.S.C.* § 2. "In enacting section 2 of the FAA, 'Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.' " *Martindale, supra,* 173 *N.J.* at 84, 800 *A.*2d 872 (quoting *Southland Corp. v. Keating,* 465 *U.S.* 1, 10, 104 *S.Ct.* 852, 858, 79 *L. Ed.*2d 1, 12 (1984)). The FAA, however, does not preclude an examination into whether the arbitration agreement at issue is unconscionable under state law. *Id.* at 85-86, 800 A.2d 872.

[2][3] "[G]enerally applicable contract defenses, such as fraud, duress, or *unconscionability,* may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs. ., Inc. v. Casarotto,* 517 *U.S.* 681, 687, 116 *S.Ct.* 1652, 1656, 134 *L. Ed.*2d 902, 909 (1996) (emphasis added); *see also Discover Bank v. Superior Court,* 36 *Cal.*4th 148, 30 *Cal.Rptr.*3d 76, 113 *P.*3d 1100, 1112-13 (Cal.2005) (stating that "the FAA does not federalize the law of unconscionability or related contract defenses except to the extent that it forbids the use of such defenses to discriminate against arbitration clauses."). Furthermore, "whether the parties have a valid arbitration agreement at all" is a "gateway" question that requires judicial resolution. *Green Tree Fin. Corp. v. Bazzle,* 539 *U.S.* 444, 452, 123 *S.Ct.* 2402, 2407, 156 *L. Ed.*2d 414, 422 (2003) (plurality opinion).

***5** [4][5] It is clear that under *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.,* 388 *U.S.* 395, 403-04, 87 *S.Ct.* 1801, 1806, 18 *L. Ed.*2d 1270, 1277 (1967), "a court must decide whether [an] agreement to arbitrate is valid." *Barker v. Golf U.S.A., Inc.,* 154 *F.*3d 788, 791 (8th Cir.1998), *cert. denied,* 525 *U.S.* 1068, 119 *S.Ct.* 796, 142 *L. Ed.*2d 659 (1999). That said, were this contract silent or ambiguous

about the availability of class-wide arbitration, an arbitrator would have to resolve the question of contract interpretation. *See Bazzle, supra,* 539 *U.S.* at 451, 123 *S.Ct.* at 2407, 156 *L. Ed.*2d at 422 (holding that when arbitration agreement is silent on subject, arbitrator is to decide "whether the agreement forbids class arbitration"). The instant agreement is not silent, however, or even ambiguous as to the availability of class arbitration. Not only does the LOAN NOTE AND DISCLOSURE FORM state that all disputes "shall be resolved by binding individual (and not joint) arbitration," but the April 28, 2003 LOAN APPLICATION also states all disputes "shall be resolved by binding individual (and not class) arbitration." Both documents also reference the NAF rules of procedure, which bar class-wide arbitrations unless all parties consent. *See NAF Rule* 19(a). Furthermore, in addition to the class-arbitration waivers found in the arbitration agreements themselves, the broad class-action waivers found elsewhere in the contracts also contain clear and unmistakable language prohibiting Muhammad's use of a class mechanism.

Other courts similarly have distinguished *Bazzle.* For example, in *Gipson v. Cross Country Bank,* 354 *F.Supp.*2d 1278, 1286 (M.D.Ala.2005), the court, in the course of upholding a particular class-arbitration waiver, stated that

> [t]he contract before this court now is distinguishable from the one in *Bazzle,* because here the clause prohibiting class arbitration is clear, that is, there is no issue of contract interpretation as there was in *Bazzle.* Put another way, the Court plurality in *Bazzle* felt that the answer as to whether the contracts allowed or prohibited class arbitration was "not completely obvious," hence contract interpretation, which is the realm of the arbitrator, would be necessary. Here, however, an arbitrator need not interpret the contract's class action waiver clause, because the contract expressly prohibits class arbitration, thereby concerning "the validity of the arbitration clause," which the *Bazzle* plurality

indicated could fall under the narrow exception concerning matters "contracting parties would likely have expected a court" to decide. There is no need for anyone to decide "whether the contract[ ] forbid[s] class arbitration." It expressly and unequivocally does. The only issue is whether such a clear prohibition is valid and enforceable....
[(Citations omitted).]

[6] For completeness we note defendants' argument that Muhammad's claims must fail because her challenge to the class-action waiver should be viewed as a challenge to the contract as a whole, and not as a specific challenge to the arbitration agreement. *Prima Paint, supra,* 388 *U.S.* 395, 87 *S.Ct.* 1801, 18 *L. Ed.*2d 1270, and *Buckeye Check Cashing, Inc. v. Cardegna,* --- *U.S.* ----, 126 *S.Ct.* 1204, 163 *L. Ed.*2d 1038 (2006), hold that because arbitration agreements are, as a matter of federal arbitration law, severable from the remainder of a contract, a challenge to a contract as a whole is for an arbitrator to decide. In this matter, however, there are two types of class-action waivers in the contracts Muhammad signed: the class-arbitration waivers and the broad class-action waivers. The broad class-action waivers could be considered distinct from the arbitration agreement in the contracts, and thus could be considered part of the "contract as a whole." In that circumstance, under *Prima Paint* and *Buckeye,* an arbitrator would address the unconscionability of the broad class-action waivers. That situation is not before us, however, because there are distinct class-arbitration waivers within the arbitration clauses of both the LOAN NOTE AND DISCLOSURE form and the APPLICATION. Those class-arbitration waivers, based on their location and subject matter, are part of the arbitration agreements, and not part of the contracts as a whole. As such, we are empowered to address this challenge.

***6** Because federal arbitration law does not prevent us from examining the validity of the class-arbitration waiver, we

turn then to our own state law requirements in respect of contract unconscionability.[FN2]

B.

[7] It is well settled that courts "may refuse to enforce contracts that are unconscionable." *Saxon Constr. & Management Corp. v. Masterclean of N.C., Inc.*, 273 *N.J.Super.* 231, 236, 641 *A.*2d 1056 (App.Div.), *certif. denied*, 137 *N.J.* 314, 645 *A.*2d 142 (1994); *see also* *N.J.S.A.* 12A:2-302 (adopting Uniform Commercial Code provision recognizing unconscionability as basis for voiding contract or clause therein). The seminal case of *Rudbart, supra,* set out factors for courts to consider when determining whether a specific term in a contract of adhesion is unconscionable and unenforceable. 127 *N.J.* at 356, 605 *A.*2d 681. In *Rudbart, supra,* this Court recognized that adhesion agreements necessarily involve indicia of procedural unconscionability. *Ibid.; see generally* *Sitogum Holdings, Inc. v. Ropes*, 352 *N.J.Super.* 555, 564-66, 800 *A.*2d 915 (Ch.Div.2002) (observing that unconscionability traditionally entails discussion of two factors: procedural unconscionability, which "can include a variety of inadequacies, such as age, literacy, lack of sophistication, hidden or unduly complex contract terms, bargaining tactics, and the particular setting existing during the contract formation process," and substantive unconscionability, which generally involves harsh or unfair one-sided terms). *Rudbart, supra,* notes that "the essential nature of a contract of adhesion is that it is presented on a take-it-or-leave-it basis, commonly in a standardized printed form, without opportunity for the 'adhering' party to negotiate except perhaps on a few particulars." 127 *N.J.* at 353, 605 *A.*2d 681.

[8][9] The determination that a contract is one of adhesion, however, "is the beginning, not the end, of the inquiry" into

whether a contract, or any specific term therein, should be deemed unenforceable based on policy considerations. *Id.* at 354, 605 A.2d 681. A sharpened inquiry concerning unconscionability is necessary when a contract of adhesion is involved.

[I]n determining whether to enforce the terms of a contract of adhesion, courts have looked not only to the take-it-or-leave-it nature or the standardized form of the document but also to [(1)] the subject matter of the contract, [(2)] the parties' relative bargaining positions, [(3)] the degree of economic compulsion motivating the "adhering" party, and [(4)] the public interests affected by the contract.

[*Id.* at 356, 605 A.2d 681.]

Because adhesion contracts invariably evidence some characteristics of procedural unconscionability, the Court required a careful fact-sensitive examination into substantive unconscionability.[FN3] *Ibid. Rudbart's* multi-factor analysis generally conforms to the case-by-case approach widely used for evaluating claims of unconscionability. *See Cheshire Mortg. Serv. v. Montes*, 223 *Conn.* 80, 612 *A.*2d 1130, 1135 (Conn.1992) (stating that, under the UCC, "[t]he determination of unconscionability is to be made on a case-by-case basis, taking into account all of the relevant facts and circumstances.").

C.

*7 The unconscionability issue in this matter centers on access to a class-wide proceeding in the arbitral setting. Although class arbitration specifically has never before been examined by this Court, the merits of the class-action procedure have been acknowledged many times in the context of court litigation. "By permitting claimants to band together, class actions equalize adversaries and provide a

procedure to remedy a wrong that might other-wise go unredressed." *In re Cadillac V8-6-4 Class Action*, 93 N.J. 412, 424, 461 A.2d 736 (1983). "If each victim were remitted to an individual suit, the remedy could be illusory, for the individual loss may be too small to warrant a suit.... Thus the wrongs would go without redress, and there would be no deterrence to further aggressions." *Riley v. New Rapids Carpet Ctr.*, 61 *N.J.* 218, 225, 294 *A.*2d 7 (1972). Other courts have referred to such small damage cases as "negative value" suits recognizing that they "would be uneconomical to litigate individually." *In re Monumental Life Ins. Co.*, 365 *F.*3d 408, 411 n. 1 (5th Cir.2004).

The class-action vehicle remedies the incentive problem facing litigants who seek only a small recovery. "[A] class action can produce a substantial fund to compensate ... [the class members'] attorney for his services." *In re Cadillac, supra*, 93 *N.J.* at 424, 461 *A.*2d 736. A "substantial fund" not only covers the attorney's actual fees, but also provides incentive in the form of possible contingency fees for attorneys to risk the prospect of receiving no recovery for their efforts. *See Amchem Products, Inc. v. Windsor*, 521 *U.S.* 591, 617, 117 *S.Ct.* 2231, 2246, 138 *L. Ed.*2d 689, 709 (1997) (stating that "[a] class action solves [the incentive problem created by small damages] by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor."); *Eisen v. Carlisle & Jacquelin*, 417 *U.S.* 156, 161, 94 *S.Ct.* 2140, 2144, 40 *L. Ed.*2d 732, 739 (1974) (stating that "[n]o competent attorney would undertake this complex antitrust action to recover so inconsequential an amount [as $70]."). The class-action mechanism also overcomes the problem that small individual recoveries may fail to provide an adequate incentive for a litigant to investigate a claim or bring suit even if the litigant could secure representation. *See Varacallo v. Mass. Mutual Life Ins. Co.* .., 226 *F.R.D.* 207, 234 (D.N.J.2005) (stating that "[a]bsent class certification, very few individuals would

have the incentive ... to bring individual claims"). And, not least of all, there is the additional justification that a class-action proceeding "can aid the efficient administration of justice by avoiding the expense, in both time and money, of relitigating similar claims." *In re Cadillac, supra*, 93 *N.J.* at 435, 461 *A.*2d 736.

[10] In sum, the class-action mechanism is recognized to be valuable to litigants, to the courts, and to the public interest. Class actions fulfill the policies of this State even when only a small amount of damages is at stake. Not surprisingly, in light of the importance of its role generally, and specifically in recognition of its usefulness in connection with small-damages actions such as are often the case in consumer suits, this Court has instructed that "the class action rule should be construed liberally in a case involving allegations of consumer fraud." *Ibid.; see also* *Strawn v. Canuso*, 140 *N.J.* 43, 68, 657 *A.*2d 420 (1995) (stating that "a class action is the superior method for adjudication of consumer-fraud claims"); *Riley, supra*, 61 *N.J.* at 228, 294 *A.*2d 7 (stating that "a court should be slow to hold that a suit [under the CFA] may not proceed as a class action."). With those justifications for the class-action vehicle in mind we turn to consider the unconscionability of the contractual waiver of class-wide arbitration before us.

III.

A.

*8 [11] The arbitration agreement signed by Muhammad is clearly a contract of adhesion. We, therefore, must apply *Rudbart's* four factors, as did the Appellate Division, in order to determine whether New Jersey contract law principles permit enforcement of the class-arbitration prohibitions

found in the instant arbitration agreements.

[12] The first three factors of the *Rudbart* analysis require only brief attention. In respect of subject matter, the circumstantial backdrop to our *Rudbart* inquiry is the payday loan agreement executed between the parties. The focus of our analysis, however, is on the agreement's mandatory arbitration provision that contains limits on discovery and bars class-wide arbitration. In respect of *Rudbart's* second factor, the gross disparity in the relative bargaining positions of the parties is self-evident from the nature of the payday loan contract between a consumer and a financial entity.[FN4] We add only that the contract Muhammad entered into is, in its most general sense, a consumer contract. Although those facts, in addition to our finding that the contract is one of adhesion, indicate a degree of procedural unconscionability in Muhammad's contract, they are insufficient to render the contract unenforceable. That said, adhesive consumer contracts, which are ordinarily enforceable, nonetheless may rise to the level of unconscionability when substantive contractual terms and conditions impact "public interests" adversely.

Rudbart's fourth factor, the most important to the present analysis, considers "the public interests affected by the contract." That factor requires us to determine whether the effect of the class-arbitration bar is to prevent plaintiff from pursuing her statutory consumer protection rights and thus to shield defendants from compliance with the laws of this State. Those "public interest" considerations ultimately determine whether we can permit enforcement of the provision in plaintiff's contract that allegedly precludes any realistic challenge to the substance of her loan-contract's terms.

[13][14] In New Jersey, exculpatory waivers that seek a release from a statutorily imposed duty are void as against

public policy. *McCarthy v. NASCAR, Inc.*, 48 *N.J.* 539, 542, 226 *A.*2d 713 (1967). Muhammad's claims are statutory; however, the class-arbitration waiver at issue, and class-action waivers in general, are not, in the strictest sense of the term, exculpatory clauses. *See Discover Bank, supra*, 30 *Cal.Rptr.*3d 76, 113 *P.*3d at 1108. The class-arbitration waiver does not preclude Muhammad from filing an individual claim in arbitration. The difficulty lies in the fact that her individual consumer-fraud case involves a small amount of damages, rendering individual enforcement of her rights, and the rights of her fellow consumers, difficult if not impossible. In such circumstances a class-action waiver can act effectively as an exculpatory clause.

To permit the defendants to contest liability with each claimant in a single, separate suit, would, in many cases give defendants an advantage which would be almost equivalent to closing the door of justice to all small claimants. This is what we think the class suit practice was to prevent.

***9** [*Delgazzo v. Kenny*, 266 *N.J.Super.* 169, 193, 628 *A.*2d 1080 (App.Div.1993) (quoting *Hohmann v. Packard Instrument Co.*, 399 *F.*2d 711, 715 (7th Cir.1968)).]

Such waivers are problematic "when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties *predictably* involve small amounts of damages," as the California Supreme Court also recognized. *Discover Bank, supra*, 30 *Cal.Rptr.*3d 76, 113 *P.*3d at 1110 (emphasis added).

In most cases that involve a small amount of damages, "rational" consumers may decline to pursue individual consumer-fraud lawsuits because it may not be worth the time spent prosecuting the suit, even if competent counsel was willing to take the case. *See Kinkel v. Cingular Wireless, LLC*, 357 *Ill.App.*3d 556, 564, 293 *Ill.Dec.* 502, 828 *N.E.*2d 812, ---- (Ill.App.Ct.) (observing that in context of individually pursued small damage claims, any potential

recovery would be offset "by any costs incurred in presenting the claim and any lost wages for taking time from work to do so."), *appeal granted*, 216 *Ill.*2d 690, 298 *Ill.Dec.* 378, 839 *N.E.*2d 1025 (Ill.2005); *see also Carnegie v. Household Int'l, Inc.*, 376 *F.*3d 656, 661 (7th Cir.2004) (commenting that "only a lunatic or a fanatic sues for $ 30."). Moreover, without the availability of a class-action mechanism, many consumer-fraud victims may never realize that they may have been wronged. As commentators have noted,

> often consumers do not know that a potential defendant's conduct is illegal. When they are being charged an excessive interest rate or a penalty for check bouncing, for example, few know or even sense that their rights are being violated. Nor, given the relatively small amounts at stake, would most consumers find it worthwhile to seek legal advice to determine whether this is the case.

[Jean R. Sternlight and Elizabeth J. Jensen, *Mandatory Arbitration: Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse*, 67 *Law & Contemp. Prob.* 75, 88 (2004).]

[15] In addition to their impact on individual litigants, class-action waivers can functionally exculpate wrongful conduct by reducing the possibility of attracting competent counsel to advance the cause of action. Class-action waivers prevent an aggregate recovery that can serve as a source of contingency fees for potential attorneys. Although defendants have no obligation to provide counsel to plaintiff, they cannot take action that impedes ordinary citizens' access to representation to vindicate their rights. Defendants emphasize the availability of attorney's fees under the CFA; however, that fact is not dispositive in the instant case because the damages sought by Muhammad and those she seeks to represent are small. The availability of attorney's fees is illusory if it is unlikely that counsel would be willing

to undertake the representation. The finance charge for the loan in this matter was $60. The class of people whom plaintiff seeks to represent may have similar claims about that size. In fact, plaintiff had to roll-over her loan two times, bringing her compensatory claims to $180 that, with the possibility of treble damages available under CFA, may add up to a maximum of less than $600. One may be hard-pressed to find an attorney willing to work on a consumer-fraud complaint involving complex arrangements between financial institutions of other jurisdictions when the recovery is so small.[FN5] It cannot be that class-action waivers are less objectionable when a plaintiff is suing under a statute that *fails* to provide for attorney's fees (and damages multipliers). Such a perverse result would encourage under-enforcement of the very statutes that the Legislature has signaled as warranting strenuous enforcement.

***10** We hold, therefore, that the presence of the class-arbitration waiver in Muhammad's consumer arbitration agreement renders that agreement unconscionable. As a matter of generally applicable state contract law, it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, whether in arbitration or in court litigation. The public interest at stake in her ability and the ability of her fellow consumers effectively to pursue their statutory rights under this State's consumer protection laws overrides the defendants' right to seek enforcement of the class-arbitration bar in their agreement.

We do not view our holding today to be at odds with the decision in *Gras v. Associates First Capital Co.*, 346 *N.J.Super.* 42, 786 *A.*2d 886 (App.Div.2001), *certif. denied*, 171 *N.J.* 445, 794 *A.*2d 184 (2002), in which the Appellate Division considered the issue before it to be whether class-action waivers were per se unenforceable. The court in *Gras, supra,* found that there was no "inherent conflict ... between arbitration and the underlying purpose of [the CFA]," 346

N.J.Super. at 52, 786 *A.*2d 886, and we agree. *Gras,* however, did not present the precise issue before the Court in this matter: whether the small amount of damages being pursued in this action involving complicated financial arrangements and multiple out-of-state entities effectively prevents plaintiff from being able to vindicate the public interests protected by the CFA.

[16] In our view, New Jersey's public policy favoring arbitration is not determinative of whether a specific class-arbitration waiver is unenforceable. Nothing in the arbitration process requires that claims be brought only by individuals. Moreover, unlike the limited discovery often found in arbitration agreements, class-arbitration waivers do not make arbitration a more streamlined and efficient forum for adjudicating disputes. One could speculate that class-arbitration waivers are viewed as more efficient because of the likelihood that fewer individual consumers would seek redress than those who would be included as part of a class. *Cf. Ting v. AT & T,* 182 *F.Supp.*2d 902, 931 n. 16 (N.D.Cal.2002) (stating that "the notion that it is to the public's advantage that companies be relieved of legal liability for their wrongdoing so that they can lower their cost of doing business is contrary to a century of consumer protection laws."), *aff'd in part, rev'd in part on other grounds,* 319 *F.*3d 1126 (9th Cir.2003). The purpose of arbitration, however, is not to discourage consumers from seeking vindication of their rights.

To be sure, many commentators have criticized, for various reasons, the class-action mechanism as it is applied in courts. *See* Sternlight and Jensen, *supra,* 67 *Law & Contemp. Prob.* at 102 (noting that "[a]cademics as well as corporate interests have pointed to ethical and efficiency issues and have argued that class actions be limited or reformed, if not eliminated."). Commentators have also suggested that class arbitration may in fact be no different or no more efficient

than class actions litigated in court. Jean R. Sternlight, *As Mandatory Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 *Wm. and Mary L.Rev.* 1, 44-53 (2000); Jack Wilson, *No-Class-Action Arbitration Clauses, State Law Unconscionability, and the Federal Arbitration Act: A Case for Federal Judicial Restraint and Congressional Action*, 23 *Quinnipiac L.Rev.* 737, 773-80 (2004). In respect of court actions, the United States Congress and/or our State Legislature may amend class-action procedures should they perceive deficiencies in the current process. And, in the context of class arbitration, contracting parties and the various arbitration forums can fashion procedural rules specific to class arbitration. Class arbitration is in its infancy and may provide a fertile ground for establishing flexible class-action procedures. *See* *Discover Bank, supra*, 30 *Cal.Rptr.*3d 76, 113 *P.*3d at 1116 (discussing California's approach to class arbitration). The drafters of arbitration agreements and forum rules, as well as the arbitrators themselves, may allow for the development of innovative class-arbitration procedures that address some of the perceived inadequacies with the current system.[FN6] That said, in order for a specific procedure to be considered "class arbitration," we presume that the essential elements of modern class actions would be present.

B.

***11** Our decision today is rooted in the fact-sensitive public interest assessment of the *Rudbart* analysis and is not based on a determination that the arbitral forum, per se, cannot accomplish vindication of a consumer-fraud litigant's rights. In *Gilmer, supra*, the United States Supreme Court stated that arbitration is allowed in actions authorized by federal statutes "[s]o long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum." 500 *U.S.* at 28, 111 *S.Ct.* at 1653, 114 *L. Ed.*2d at 38

(quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 *U.S.* 614, 637, 105 *S.Ct.* 3346, 3359, 87 *L. Ed.*2d 444, 462 (1985)). That analysis was used again by the Court in *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 *U.S.* 79, 90, 121 *S.Ct.* 513, 521, 148 *L. Ed.*2d 373, 383 (2000). Defendants argue that those holdings prevent the conclusion that we reach today in respect of Muhammad's arbitration agreement. We reject that argument.

Our analysis does not focus solely on the ability of Muhammad to individually vindicate her statutory rights. Our consideration of "the public interests affected by the contract" under *Rudbart* compels a broader inquiry into how class-action waivers affect the various interests protected under the CFA. Moreover, the analysis undertaken in *Gilmer* and *Randolph* reconciled various remedial federal statutes with the FAA. In *Randolph, supra,* the Court noted as part of its inquiry that it must "ask whether Congress has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue." 531 *U.S.* at 90, 121 *S.Ct.* at 521, 148 *L. Ed.*2d at 383. That is a uniquely federal question, distinct from an analysis of *state* contract law under *Rudbart.* The California Supreme Court observed similarly in *Discover Bank, supra,* when examining federal cases that have applied *Gilmer* and *Randolph*, 30 *Cal.Rptr.*3d 76, 113 *P.*3d at 1114 n. 6. Noting the difference between the federal "vindication of statutory rights" test and an unconscionability analysis under state law, the California Supreme Court stated that the decisions following the former approach "address whether a federal statute impliedly limits arbitration, [and] are obviously not binding on this court when it decides whether class arbitration waivers are unconscionable under state law principles." *Ibid.; see also Kristian v. Comcast Corp.*, 446 *F.*3d 25, 60 n. 22 (1st Cir.2006) (concluding similarly that state unconscionability analysis, which is "based on the particulars of state contract law, may include considerations not present in the

vindication of statutory rights analysis .... which is not dependent on state law."); *In re: Universal Fund Telephone Billing Practices Litigation*, 300 *F.Supp.*2d 1107, 1136-38 (D.Kan.2003) (treating procedural unconscionability and availability of "[an] effective forum to vindicate statutory rights" as distinct inquiries).

C.

***12** [17][18][19][20] Finally, although we find that the class-arbitration waivers in Muhammad's arbitration agreements are unconscionable and unenforceable, we find that the waivers are severable. Once the waivers are removed, the remainder of the arbitration agreement is enforceable. As the Eleventh Circuit has explained,

[i]f all the provisions of the arbitration clause are enforceable, then the court must compel arbitration according to the terms of the agreement. If, however, some or all of its provisions are not enforceable, then the court must determine whether the unenforceable provisions are severable. Severability is decided as a matter of state law. If the offensive terms are severable, then the court must compel arbitration according to the remaining, valid terms of the parties' agreement. The court should deny the motion to compel arbitration only where the invalid terms of the arbitration clause render the entire clause void as a matter of state law.

[*Terminix Int'l Co. LP v. Palmer Ranch Ltd. P'ship*, 432 *F.*3d 1327, 1331 (11th Cir.2005) (citation omitted).]

Similarly, our courts have recognized that "[i]f a contract contains an illegal provision and such provision is severable, courts will enforce the remainder of the contract after excising the illegal portion, so long as the prohibited and valid provisions are severable." *Schuran, Inc. v. Walnut Hill*

Assocs., 256 *N.J.Super.* 228, 233, 606 *A.*2d 885 (Law Div.1991); *see also Naseef v. Cord, Inc.*, 90 *N.J.Super.* 135, 143, 216 *A.*2d 413 (App.Div.) (stating "[i]t is true that if a contract contains an illegal provision, if such provision is severable the courts will enforce the remainder of the contract after excising the illegal portion."), *aff'd*, 48 *N.J.* 317, 225 *A.*2d 343 (1966). The instant contracts embrace that proposition in that the broad class-action waivers in both contracts use the language "[t]o the extent permitted by law." Thus, the contracts reflect an intention that the arbitration agreement would be implemented whether and to whatever extent class-wide arbitration might be barred. Because we hold that the class-arbitration bar is not enforceable, we need not address plaintiff's additional argument about the impact of the discovery limitations on an individual arbitration claim.

IV.

The judgment of the Appellate Division is reversed and the matter is remanded to the Law Division for further proceedings consistent with this opinion.

Chief Justice PORITZ and Justices LONG, ZAZZALI, and WALLACE join in Justice LaVECCHIA's opinion. Justice RIVERA-SOTO filed a separate opinion concurring in part and dissenting in part. Justice ALBIN did not participate.Justice RIVERA-SOTO, concurring in part and dissenting in part.

To the extent the majority holds that the arbitration agreements in this case are enforceable, *ante*, --- *N.J.* ---- (2006) (slip op. at 32), I concur. However, to the extent the majority holds that the class-arbitration waivers in plaintiff's arbitration agreements are unconscionable, *ante*, --- *N.J.* ---- (2006) (slip op. at 26), I respectfully dissent for the reasons thoughtfully and exhaustively set forth by both the Appellate

Division, *Muhammad v. County Bank of Rehoboth Beach, Del.*, 379 *N.J.Super.* 222, 877 *A.*2d 340 (App.Div.2005), and the trial court.

For reversal and remandment-Chief Justice PORITZ and Justices LONG, LaVECCHIA, ZAZZALI and WALLACE-5.
For concurrence in part; dissent in part-Justice RIVERA-SOTO-1.
Not Participating-Justice ALBIN.

FN1. If the parties fail to agree on discovery matters, *NAF Rule* 29C allows mandatory discovery where the "cost [of discovery] is commensurate with the amount of the Claim." Muhammad contends that because her damages are only $180, limiting discovery to that amount, in the context of a complex claim, precludes her from obtaining relief.

FN2. The Appellate Division concluded that defendants had waived any argument that Delaware law should be applied (based on a choice of law clause in the contract). The panel found the issue to have been waived because it was not raised before the trial court and was raised only in a footnote in defendants' Appellate Division brief. *Muhammad, supra*, 379 *N.J.Super.* at 234 n. 3, 877 *A.*2d 340. Defendants did not seek review of the Appellate Division's determination of that issue.

FN3. This is not to say that when a contract of adhesion involves overwhelming procedural unconscionability, that those procedural factors are not included and weighed in the overall analysis for unconscionability. *See, e.g., Discover Bank, supra*, 36 *Cal.*4th 148, 30 *Cal.Rptr.*3d 76, 113 *P.*3d 1100 (finding gross unfairness in contract formation when

bill stuffer contained adhesion contract's terms). In that circumstance a "sliding scale" analysis may be appropriate. *See* Sitogum Holdings Inc., *supra*, 352 N.J.Super. at 565-66, 800 A.2d 915 (noting that courts have employed a "sliding scale" analysis when considering, in tandem, the two factors of procedural and substantive unconscionability).

FN4. The third *Rudbart* factor addresses the degree of economic compulsion motivating the "adhering" party. In respect of that factor we note only that payday loans may be necessities for persons who need access to cash and who may have credit difficulty, compelling their acquiescence to loans bearing exorbitant interest rates. Muhammad seeks to represent a class of people who, like herself, are under an allegedly high degree of economic compulsion to enter into such loan contracts.

FN5. In many respects, this is a fact-sensitive analysis and close cases may require the development of some proofs by a putative class plaintiff and fact-finding on the court's part. *See* Sternlight and Jensen, *supra*, 67 *Law & Contemp. Prob.* at 87 (stating that "[t]estimony from parties, local attorneys, or experts can establish which claims plaintiffs and their attorneys deem worth bringing. Such testimony needs to be specific as to what kinds of damages and attorney's fees would be available for individual claims [and] why these are insufficient"). At some point, an amount of damages will be high enough to attract counsel if attorney's fees are available, even though no counsel would take the same case if no attorney's fees were available. When "substantial damages" are at stake, the court should consider whether the availability of attorney's fees (including possible fee enhancement, *Rendine v. Pantzer*, 141

N.J. 292, 661 *A.*2d 1202 (1995)) in conjunction with a substantial potential damages award (including potential statutory multipliers) would allow a "substantial number" of consumers to obtain counsel and seek relief.

FN6. One objection lodged against class actions is that because the stakes are so high, defendants are pressured into settling arguably frivolous claims. The amicus Chamber of Commerce advances that concern, noting the "hydraulic pressure to settle that class certification creates." *See also In re Rhone-Poulenc Rorer Inc.*, 51 *F.*3d 1293, 1299-1300 (7th Cir.) (noting that class certification can force defendants to stake "their companies on the outcome of a single jury trial," whereas numerous individual trials would "reflect a consensus, or at least a pooling of judgment, of many different tribunals.") (Posner, J.), *cert. denied,* 516 *U.S.* 867, 116 *S.Ct.* 184, 133 *L. Ed.*2d 122 (1995); Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action,* 104 *Mich. L.Rev.* 373, 374 (2005) (noting criticism that class certification gives "outsized leverage" to "even the most baseless of class claims."); Wilson, *supra,* 23 *Quinnipiac L.Rev.* at 778 (stating in respect of class arbitration that "companies must fear that a 'renegade arbitrator' will enter an enormous judgment, which almost certainly would be subject to only the traditional, limited judicial review of arbitral awards."). Those concerns could be addressed through class-arbitration rules drafted to establish methods that spread the risks associated with a single decision-maker while still preserving many of the efficiencies of the modern class-action procedure.

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